INVESTMENT SECURITIES.—IV.

BY FINANCIER.

Prior Lien Bonds.—The lien of bonds of this class, as their name indicates, is superior to that of some other issue. They may or may not be first-mortgage bonds.

The Erie Railroad Prior Lien Four Per Cent. Bonds of 1996 are so called because they take precedence over the General Mortgage Bonds. There are, however, six issues secured by liens on a substantial portion of the main line of the system to which the Prior Lien Bonds are junior.

The Northern Pacific Railroad Prior Lien Four Per Cent. Bonds of 1997 are secured by a first mortgage on substantially the entire property of the Northern Pacific Railroad, and are therefore regarded as very conservative bonds.

The Baltimore and Ohio Prior Lien Three and a half Per Cent. Bonds of 1925 are secured by a lien, which is practically tantamount to a first mortgage, on a considerable portion of the main line of the road. These bonds are, therefore, favorably regarded among investment securities.

Divisional Mortgage Bonds.—Bonds characterized as Divisional Mortgage Bonds are usually the obligations of a large road, and further secured by a lien on a particular Division. The merit of this class of bonds, therefore, depends upon the strength of the issuing corporation and the importance of the Division. The Chicago, Burlington and Quincy Railroad, Illinois Division, Three and a half Per Cent. and Four Per Cent. Bonds are justly regarded as gilt-edged securities. The issuing company, the Chicago, Burlington and Quincy Railroad, enjoys the highest credit, and the Illinois Division, upon which these bonds are secured, comprises the main line and branches of the road lying in the rich and populous northeastern quarter of Illinois. The

Chicago, Milwaukee and St. Paul Railway likewise has a number of Divisional Mortgage Bonds, all of which are classed as high-grade investments.

Branch Mortgage Bonds.—Branch Mortgage Bonds are very similar in character to many Divisional Mortgage Bonds. A Branch, however, obviously cannot well be a part of the main line of a system, whereas a Division may be. Few securities designated as Branch Mortgage Bonds have been issued during the past decade. The Missouri Pacific Railroad has outstanding an issue of bonds of this character; they are known as the Pacific Railroad of Missouri, Carondolet Branch, Four and a half Per Cent. Bonds of 1938.

Guaranteed and Assumed Bonds.—When a large system absorbs a small road, it frequently buys the stock of the latter and guarantees its bonded indebtedness. The Guarantee is endorsed on the bonds of the subsidiary company and signed by the proper officials of the parent corporation. A Guarantee is strictly construed, and it should be as simple and brief as possible. The Guarantee of the Union Pacific Railroad appearing upon the Refunding Mortgage Bonds of the Oregon Short Line, due in 1929, is worded as follows:

> "For Value Received, Union Pacific Railroad Company unconditionally guarantees to the owner of the within bond the punctual payment of the principal and interest thereof as the same mature, and agrees itself punctually to pay the said principal and interest if default in the payment thereof be made by the Oregon Short Line Railroad Company."

When one railroad leases the property of another, it is frequently provided in the lease that the lessee corporation shall become responsible for all the obligations of the lessor corporation. It is almost necessary for the proper protection of the bondholders of the lessor, when the property by a pledge of which their bonds are secured is taken over and operated by another corporation, that their bonds should become practically a part of the indebtedness of the larger corporation. Especially is this so if the earnings of the smaller road are not kept separately, but are included in those of the lessee.

There may appear no intimation on the bonds of the subsidiary corporation that they have been assumed by another corporation. To inform himself of the terms and conditions upon which his bonds are assumed, the holder must turn to the lease.

Leases of this character usually run for a very long period. Their term should, of course, be greater than that of the bonds assumed. The Rome, Watertown and Ogdensburg Railroad is leased for the period of its corporate existence by the New York Central Railroad, which assumes all of the former's indebtedness. Many leases run for 999 years.

A few leases provide that their terms may be altered, or that the leases themselves may be terminated by the mutual agreement of both corporations. As far as the bondholder is concerned, a provision of this sort reduces the value of the assumption.

The worth of guaranteed and assumed bonds depends upon two considerations,—the value of the property upon which they are a lien, and the credit of the corporation guaranteeing or assuming the bonds.

Debentures.—Debentures, or Debenture Bonds, are not secured by a mortgage or by a lien on any specific property of the issuing corporation. For this reason, they are sometimes called "Plain Bonds." They are similar to the unsecured notes of an individual or corporation. In Europe, there are issued Debentures which are secured by the pledge of stocks or bonds as collateral, and, formerly, in the United States the word "Debenture" was not used to denote exclusively unsecured bonds. Now, however, the classification of plain bonds, not specially secured, as Debentures, is, in this country at least, pretty well established.

Some Debentures are issued by railroad corporations without the formality of entering into an agreement with a trustee for the benefit of the bondholders. Under such circumstances, the bond itself is the only instrument bearing upon the corporation's obligation.

The interest of a Debenture holder, however, is better protected when the railroad company enters into an agreement with a trustee, in which are set out in full the covenants of the railroad. An indenture of this kind usually shows that the issue has been properly authorized, and provides for certification by the trustee in order that the bonds may be properly authenticated, and in order that no more than the authorized amount may at any time be outstanding. The advantage to a Debenture holder in having his rights protected by an agreement or indenture lies, also, in the fact that, in case of violation of any of the covenants by the railroad, the trustee, as a representative of the bondholders,

is in a position to take whatever steps may be proper to protect their interests.

While Debenture Bonds are not secured by a lien on any specific property of the company, there is frequently inserted in the indenture, covering the rights of the bondholders, a provision that, so long as any of the Debenture Bonds are outstanding and unpaid, the railroad company will not make any new mortgage upon its railroad without also thereby including therein every bond issued under the indenture equally and ratably with other bonds issued under and secured by any such mortgage. The Lake Shore and Michigan Southern Railway Company has two issues of Debentures outstanding, and in each instance the indenture provides against further issues of mortgage bonds without including the outstanding Debentures.

Only railroads of the first class can sell their unsecured bonds or Debentures at fair prices. Debentures rank inferior, of course, to all the mortgage securities of a road. Debenture holders are, however, creditors of the corporation, and their claim for both principal and interest must be satisfied before any distribution of dividends or assets of the corporation can be made to the stockholders; in other words, all classes of stock of a corporation are inferior as securities to the Debentures.

Convertible Bonds.—Bonds of this class may, on certain terms, be converted by their owners into the capital stock of the issuing corporation. In respect to security, Convertible Bonds are usually Debentures, *i. e.,* they are not secured by any lien or mortgage. Some convertible issues likewise are protected by an agreement on the part of the issuing road not to place any new mortgage on its property without including therein the convertible issue. The Atchison, Topeka and Santa Fé Convertible Four Per Cents. of 1955 and Convertible Five Per Cents. of 1917 are so protected.

The terms upon which the bonds may be converted into stock vary greatly. Some bonds are convertible into stock at par. Others are exchangeable for stock below par, and still others for stock above par. The Pennsylvania Railroad Convertible Three and a half Per Cent. Bonds of 1915 are convertible into stock at 150 per cent. of their par value; that is, bonds to the face value of $15,000 are convertible into stock to the face value of $10,000. The Union Pacific Four Per Cent. Convertibles are exchangeable for Common Stock of the company at $175 per

share; expressed differently, the bonds represent a "call" upon Union Pacific Common at 175.

If Convertible Bonds are purchased at a quotation under par, it follows that they represent a call upon the stock at a price below the exchange rate named in the bond.

Most Convertible Bonds may be called for payment by the issuing company upon giving proper notice. The price at which they are redeemable is, however, usually well above the issue price, and an opportunity is always to be given to the holder to convert his bonds into stock prior to the date on which they are to be redeemed, should he so elect.

The period during which the bonds are convertible may be deferred for several years after the date of issue of the bonds, or may be limited to a portion only of their term.

The New York, New Haven and Hartford Railroad has recently authorized an issue of bonds which will not become convertible into the stock of the company until 1923. The bonds bear six per cent. interest, and, while this rate is regarded as very high for a corporation enjoying first-rate credit, yet the cost to the company of the money borrowed by means of these bonds will be less than it would have been had the money been raised by issuing stock at par, and should the company continue to pay eight per cent. dividends on its stock.

Large amounts of money have heretofore been borrowed by various roads on Convertible Bonds bearing three and a half per cent. and four per cent. interest. A convertible issue offers several advantages to the issuing company. The road anticipates that in the course of time, after the improvements, the cost of which was raised by the bond issue, have been completed and begin to produce or to increase income, the bonds will be converted into stock. Pending their conversion, they bear a comparatively low rate of interest. When the bonds are finally converted, the fixed interest charges will be reduced, and the credit and borrowing power of the road will stand unimpaired.

Convertible Bonds appeal to the investor who desires a moderately conservative security which likewise enjoys the speculative possibility of a material enhancement in market value, should a decided rise occur in the Stock Exchange quotations for the shares into which the bonds may be converted.

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